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Key foundations for high-quality corporate reporting: International audit and assurance requirements and good practices in their implementation

Note by the UNCTAD secretariat

Executive summary

The UNCTAD Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting has been developing an Accounting Development Tool for high-quality corporate reporting. The Tool comprises the following four pillars: legal and regulatory framework; institutional framework; human capacity; and capacity-building process. Auditing and assurance standards are essential components of the Tool.

In concluding its deliberations at its thirty-first session, the Intergovernmental Working Group of Experts proposed, under the theme of key foundations for high-quality corporate reporting, international audit and assurance requirements and good practices in their implementation as one of its main agenda items for consideration at its thirty-second session. This area is one of the key components of the Accounting Development Tool. Accordingly, the UNCTAD secretariat has prepared this background note with a view to facilitating the deliberations of the Intergovernmental Working Group of Experts on this topic. The note presents an overview of trends in the development and implementation of the International Standards on Auditing, as well as the related implementation challenges of such standards pertaining to regulatory, institutional and human capacity requirements.

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I. Introduction

1. For over three decades, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting has been contributing to global efforts aimed at promoting high-quality financial and non-financial reporting by enterprises around the world, to enhance financial stability and good governance and improve the investment climate.

2. Since 2010, annual sessions of the Intergovernmental Working Group of Experts have been dedicated to developing a comprehensive approach to achieving high-quality corporate reporting as a critical component of an enabling investment environment. To this end, over the past five years, the Intergovernmental Working Group of Experts has developed an Accounting Development Tool and applied it in different regions of the world. The Tool, consisting of an accounting development framework [1] and a set of accounting development indicators,[2] has been further enhanced and is now accessible from a web-based electronic platform, available in four languages, namely English, French, Russian and Spanish (see http://adt.unctad.org).

3. The Tool was developed to assist member States in identifying gaps between their domestic corporate reporting requirements and international standards and codes and, through this process, to develop an action plan to address the gaps in a consistent and comparative manner. In this regard, the Tool facilitates the design and implementation of sustainable strategies and action plans towards convergence with international standards and best practices. It promotes an open and constructive dialogue among key stakeholders involved in the corporate reporting supply chain. Audit and assurance standards are essential elements of the Tool.

4. In concluding its deliberations at its thirty-first session, the Intergovernmental Working Group of Experts proposed, under the theme of key foundations for high-quality corporate reporting, international audit and assurance requirements and good practices in their implementation as one of its main agenda items for consideration at its thirty-second session. Current work on this topic builds on previous work by the Intergovernmental Working Group of Experts, including a note entitled "Practical challenges and related considerations in implementing international standards on auditing", prepared by the UNCTAD secretariat in 2008 in cooperation with the International Auditing and Assurance Standards Board; [3] a forthcoming document on the monitoring of compliance and enforcement with guidance on capacity-building and good practices; and five country case studies on monitoring and compliance conducted by UNCTAD for Australia, Belgium, Canada, Germany and the United Kingdom of Great Britain and Northern Ireland, discussed at the thirty-first session of the Intergovernmental Working Group of Experts.[4]

5. The UNCTAD secretariat has prepared this background note with a view to facilitating the deliberations of the Intergovernmental Working Group of Experts on this topic. The note presents an overview of trends on the convergence towards International Standards on Auditing and discusses key foundations for the implementation of such

[1] TD/B/C.II/ISAR/56 and TD/B/C.II/ISAR/56/Add.1.
[2] TD/B/C.II/ISAR/59.
[3] TD/B/C.II/ISAR/49 and UNCTAD, 2010, *International Accounting and Reporting Issues: 2008 Review* (New York and Geneva, United Nations publication).
[4] UNCTAD, forthcoming, *International Accounting and Reporting Issues: 2014 Review* and *International Accounting and Reporting Issues: 2015 Review*.

standards and the main capacity-building challenges. It also suggests issues for further consideration.[5]

II. Overview of trends on the convergence towards the International Standards on Auditing

A. Development of the International Standards on Auditing and clarity project

6. Auditing and assurance standards are essential components of the corporate reporting supply chain. The need to raise financing from a wider base of investors and lenders has brought about the separation of ownership of enterprises from the day-to-day management of their operations. As a result, lenders, investors and other stakeholders place a higher level of confidence in financial and non-financial reports prepared by the management of enterprises when such reports are accompanied by an attestation from a competent third party, such as an auditing firm.

7. Globalization and the close integration of the world economy has made the development of global standards of reporting and auditing necessary.[6] In March 1978, the International Auditing Practices Committee was established to develop international auditing guidelines under the auspices of the International Federation of Accountants. In 1991, the Committee recodified its guidelines and issued them as International Standards on Auditing.

8. In 2002, following a comprehensive review, the Committee was replaced by the International Auditing and Assurance Standards Board. In 2004, the Board initiated a comprehensive revision and redrafting of its standards under a clarity project, which was completed in 2009. In carrying out this project, more than half of the 36 International Standards on Auditing were subjected not just to clarification, but also to substantive changes intended to improve audit practices (and are hereafter referred to as clarified ISAs). Clarified ISAs have received support from international organizations such as the Basel Committee on Banking Supervision, UNCTAD and the World Bank. Furthermore, the International Organization of Securities Commissions endorsed the standards in June 2009 for the cross-border offering of shares and listings among its members.[7]

9. Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014, amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, states that member States of the European Union shall require statutory auditors and audit firms to carry out statutory audits in compliance with international auditing standards adopted by the European Commission. The European

[5] This note has benefited from input compiled from publicly available sources and made available to the secretariat by Javed Siddiqui, Senior Lecturer in Accounting, Manchester Business School, University of Manchester, United Kingdom.

[6] C Humphrey and A Loft, 2011, Moving beyond nuts and bolts: The complexities of governing a global profession through international standards, in: S Ponte, P Gibbon and J Vestergaard, eds., *Governing Through Standards: Origins, Drivers and Limitations*, Palgrave MacMillan, Basingstoke, United Kingdom: 102–129.

[7] For a summary of the status of implementation, see International Auditing and Assurance Standards Board, 2010, Implementation of the clarified International Standards on Auditing, International Federation of Accountants. Evidence of support for global convergence with the standards is also discussed in UNCTAD, 2010, *International Accounting and Reporting Issues: 2008 Review* (New York and Geneva, United Nations publication).

Union has provided financing to the Public Interest Oversight Board, a body that oversees due process in relation to the standard-setting activities of the International Auditing and Assurance Standards Board, among others.[8] In April 2014, the European Parliament passed a regulation to provide backing for continued financing of the Board for 2014–2020 (see http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.105.01.0001.01.ENG). The International Standards on Auditing also received support from a detailed academic study funded by the European Community, which concluded that the "adoption of the clarified ISAs through the European Union would contribute to the credibility and quality of financial statements and to audit quality in the European Union".[9] However, official endorsement by the European Union of the International Standards on Auditing is still in discussion.

10. In 2013, the International Auditing and Assurance Standards Board published a post-implementation review of the clarified ISAs. The findings suggested that the clarification exercise enhanced the understandability of the International Standards on Auditing and that the clarified ISAs had been well received by auditors. The Board noted that improvement to aspects of some standards were necessary to achieve greater consistency and effectiveness in their application. It is important to recall that, in order for the clarified ISAs to be adopted and effectively implemented, it takes time to make changes to national auditing standards arising from translation and legislative processes and changes to firms' audit methodologies. The Board also noted the importance of auditor education, training and implementation guidance, in particular for small and medium-sized enterprises (SMEs), to ensure high-quality audits. During the consultation process of the Board, suggestions were made for the enhanced use of plain English and avoidance of boilerplate or overloaded wording, in order to enhance the understandability of the clarified ISAs.[10]

11. Based on the post-implementation review, the International Auditing and Assurance Standards Board issued its work plan and a consultation paper on its proposed strategy for 2015–2019.[11] The first strategic objective identified by the Board was to develop and maintain high-quality International Standards on Auditing that are accepted as the basis for high-quality financial statement audits. To fulfil this objective, the Board has indicated that it will invest significant effort in responding to key implementation issues identified by the Board's implementation monitoring project in the period 2015–2019. A review of the responses to the work plan and strategy indicates that professional accountancy bodies and regulators worldwide are generally supportive of the strategy for 2015–2019, which sets the basis for further development and promotion of the International Standards on Auditing.

B. Non-financial reporting

12. In the ongoing process of developing International Standards on Auditing, increasing attention is paid to the area of non-financial reporting. Revised standard No. 720 requires auditors to read non-financial information contained in annual reports and consider

[8] The Public Interest Oversight Board was established in February 2005 to ensure that international auditing and assurance, ethics and education standards for the accountancy profession are set in a transparent manner that reflects the public interest. It is a global independent oversight board and a collaborative effort by the International Federation of Accountants and the international financial regulatory community.

[9] University of Duisberg-Essen, 2009, Evaluation of the possible adoption of International Standards on Auditing in the European Union, Study on International Standards on Auditing Markt/2007/15/F.

[10] International Auditing and Assurance Standards Board, 2013, Clarified International Standards on Auditing: Findings from the post-implementation review, International Federation of Accountants.

[11] International Auditing and Assurance Standards Board, 2014, Work plan for 2015–2016: Enhancing audit quality and preparing for the future, International Federation of Accountants.

whether there is a material inconsistency between such information and the financial statements or auditor knowledge obtained during an audit.[12] The wording of the revised standard thus acknowledges that although the content of annual reports may vary, depending on laws, regulations or customs in a particular jurisdiction, one or more of the following documents may form part of the annual report: management report; management commentary; operating and financial review or a similar report by those charged with governance; chair's statement; corporate governance statement; or internal control and risk assessment report.

13. The wording of the revised standard acknowledges, however, that an annual report is different in nature, purpose and content from other reports, such as a report prepared to meet the information needs of a specific stakeholder group or to comply with a specific regulatory reporting objective, even when such a report is required to be publicly available. Such standalone documents are not typically part of an annual report (subject to laws, regulations or customs) and hence do not fall under the purview of the International Standards on Auditing. Examples of such standalone reports are those on the following: a separate industry or regulatory body; corporate social responsibility; sustainability; diversity and equal opportunity; labour practices and working conditions; and human rights.

14. The International Standards on Auditing include standards on assurance engagements other than audits or reviews of historical financial information. International Standard on Assurance Engagements No. 3000 was revised and issued by the International Auditing and Assurance Standards Board in December 2013. A related standard is No. 3410, on greenhouse gas statements. Recent studies on trends in assurance related to non-financial information indicate that the number of reports that include an assurance statement by an external party has been increasing. According to a study conducted by the Global Reporting Initiative, nearly two thirds of such assurance engagements were conducted by accountancy firms.[13] The most common level of assurance issued by accountancy firms was limited assurance in accordance with No. 3000. In addition to accountancy firms, other entities such as engineering and environmental consultancy firms provide assurance services on greenhouse gas statements. Such assurance providers apply the International Organization for Standardization standard No. 14064-3:2006 (part 3 – specification with guidance for the validation and verification of greenhouse gas assertions), rather than No. 3410.[14]

C. Small and medium-sized enterprises

15. The scope of the clarified ISAs covers audits of entities of all sizes. The International Auditing and Assurance Standards Board notes that the effectiveness of the application of the standards depends on the effectiveness of related training programmes. The responsibility for developing and conducting such training programmes rests with national professional accountancy bodies, as well as individual audit firms.[15]

[12] International Auditing and Assurance Standards Board, 2015, International Standard on Auditing 720 (revised): The auditor's responsibilities relating to other information and related conforming amendments, International Federation of Accountants.

[13] Global Reporting Initiative, 2013, The external assurance of sustainability reporting, Research and Development Series.

[14] A Huggins, WJ Green and R Simnett, The competitive market for assurance engagements on greenhouse gas statements: Is there a role for assurers from the accounting profession, *Current Issues in Auditing*, 5(2):1–12.

[15] International Auditing and Assurance Standards Board, 2010.

16. Professional bodies in countries that have adopted the International Standards on Auditing are, in general, providing adoption and implementation support to small and medium-sized audit firms for audits of SMEs, including detailed guidelines and practice aids.[16] In 2011, the International Federation of Accountants, in cooperation with the Canadian Institute of Chartered Accountants, developed the *Guide to Using International Standards on Auditing in Audits of Small and Medium Entities*. Its objective is to help practitioners understand and efficiently apply the clarified ISAs to SMEs. It contains practical material on performing audits of SMEs, including illustrative case studies for micro enterprises and SMEs.

D. Public sector

17. With regard to the public sector, the International Standards on Auditing are incorporated into the International Standards of Supreme Audit Institutions, issued by the International Organization of Supreme Audit Institutions. The organization's guidelines allow a reference in financial audits to be made, either to the International Standards on Auditing or to the International Standards of Supreme Audit Institutions. The latter provide additional public sector guidance, although the requirements are the same for an auditor in financial audits. International Standards on Auditing constitute an indivisible set of standards and the International Standards of Supreme Audit Institutions in which they are incorporated may not be referred to individually. If either set of standards is adopted as the standards for financial audits of a supreme audit institution, an auditor's report should include a reference to the standards.[17] This applies equally to financial audits conducted in combination with other types of audits, such as performance or compliance audits.

E. Recent trends in the adoption of the International Standards on Auditing

18. The number of countries adopting the International Standards on Auditing is growing, while the approaches to adoption vary. According to data from the International Auditing and Assurance Standards Board, 106 countries to date have either adopted International Standards on Auditing[18] or intend to do so in the near future (see http://www.iaasb.org/clarity-center/support-and-guidance).[19] The number of countries by geographical region is as follows: Africa and the Middle East, 26; Americas, 18; Asia and Oceania, 21; and Europe, 41. This includes all member States of the European Union, with the exception of France, Germany and Portugal, pending adoption of the International Standards on Auditing by the European Commission.[20] Portugal is in the process of

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[16] Ibid.

[17] International Organization of Supreme Audit Institutions, 2013, Fundamental principles of public sector auditing.

[18] The key adoption categories are standards required by a national law or regulation; standards adopted by a national audit standards setter; national standards that are essentially the same as the International Standards on Auditing, with modifications consistent with the Board's modification policy; standards with informational inadequacies with respect to the translation process utilized for the International Standards on Auditing or the adopted modification policy; and/or standards that, despite declared commitments to convergence with the International Standards on Auditing, have not yet been converged in practice.

[19] It is not clear from the data provided how many countries are actually implementing International Standards on Auditing or how soon the remaining countries plan to implement them.

[20] Federation of European Accountants, 2015, Overview of International Standards on Auditing adoption in the European Union.

adopting the clarified ISAs (see http://www.internationalaccountingbulletin.com/news/three-eu-members-yet-to-adopt-international-auditing-standards-4562247/).

19. In 29 jurisdictions, the International Standards on Auditing have generally been adopted as local standards with some modifications, in line with the Board's modification policy (see http://www.ifac.org/system/files/downloads/Modification_Policy_Position.pdf). In some jurisdictions, local auditing standards are similar to the International Standards on Auditing. However, it is not clear whether the modifications are consistent with the Board's modification policy. Also, some countries have declared convergence with International Standards on Auditing as an objective, but have not yet achieved this.[21] In some countries, such as Australia, the Netherlands and the United Kingdom, national auditing standard setters have discontinued domestic audit standard-setting activities independent of the International Standards on Auditing.

20. One important player in global financial markets that has not yet implemented the International Standards on Auditing is the United States of America. Auditing standards that are accepted in the United States are set by the Public Company Accounting Oversight Board. The United States Securities and Exchange Commission has not endorsed the International Standards on Auditing for audits of domestic or foreign listed companies whose securities are traded in an exchange based in the United States. Despite frequently drawn contrasts between the International Standards on Auditing and auditing standards of the Public Company Accounting Oversight Board, substantive differences are limited (see http://ec.europa.eu/internal_market/auditing/docs/ias/evalstudy2009/appendix_en.pdf). However, during the consultation process of the International Auditing and Assurance Standards Board, it was noted that full adoption by the United States of the clarified ISAs could significantly affect the decision of other jurisdictions to do the same.[22]

21. The International Standards on Auditing are also applied for major company audits performed by large audit firms throughout the world, under the Forum of Firms agreement. This agreement requires members to promote the consistent application of high-quality audit practices worldwide, including the use of the International Standards on Auditing, and support the convergence of national audit standards with the international standards. As much as possible, Forum members must perform transnational audits in accordance with the International Standards on Auditing (see http://www.ifac.org/system/files/uploads/TAC-FoF/Fact-Sheet-FoF-TAC.pdf).

III. Key foundations for the implementation of the International Standards on Auditing and capacity-building challenges

22. The processes of practical implementation and any subsequent impacts of the International Standards on Auditing (or any other set of auditing standards), depend significantly on the environment, the national regulatory and institutional capacity, the availability of resources and the context in which the standards are applied. Certain issues in this regard are highlighted in this chapter.

[21] For example, in Australia, the Auditing and Assurance Standards Board has a clear statement on the use of the International Standards on Auditing as a basis for Australian auditing standards, with amendments necessary for the statutory and regulatory environment; in Norway, the International Standards on Auditing have been adopted as national standards and are amended as necessary to address differences due to national regulatory requirements; and in Singapore, editorial amendments have been made to the International Standards on Auditing to accommodate local differences (see https://www.ifac.org/system/files/uploads/MBD/Basis-of-ISA-Adoption-by-Jurisdiction-August-2012.pdf for a detailed analysis of adoption by jurisdiction as of August 2012).

[22] Comments made by the Institute of Certified Public Accountants, Republic of Korea.

A. Legal and regulatory requirements

23. Legal and regulatory requirements may take different forms, depending on the background and culture of a country. However, some common aspects may be identified based on experience gained from years of accounting and audit reforms aimed at the facilitation of international harmonization and improving the quality of corporate reporting.

24. As suggested in the Accounting Development Tool capacity-building framework,[23] the following elements should be considered in building legal and regulatory foundations with respect to auditing:[24]

- Audit standards and requirements
- Enforcement of standards (endorsement where applicable)
- Monitoring and compliance of standards with requirements
- Licensing of auditors
- Training of accountants, auditors, regulators and other stakeholders and participants in the reporting chain
- Corporate governance
- Ethical standards
- Investigation and discipline
- Quality assurance mechanism
- Auditor liability and accountability

1. Audit standards

25. The International Standards on Auditing can be seen as process standards that provide guidance on how to carry out various steps of an audit process with an implicit expectation that following the steps will enable an auditor to provide high-quality service. Standards are presented in groups; standards 200–299, for example outline an auditor's responsibilities, as well as the nature and general organization of an audit, including audit documentation and internal quality control. Other groups provide for technical guidance on specific aspects of an audit, such as audit planning (300–499), evidence gathering (500–599), using the work of others during an audit (600–699) and preparing an auditor's report (700–799). There are some critical areas that need to be considered for developing a solid regulatory foundation for the implementation and application of the International Standards on Auditing.

26. One such area is audit quality. Following the 2008 global financial crisis, there have been growing calls for improving audit quality. However, this area remains a challenge and the debate on how to define audit quality continues. The range of definitions is quite broad, each focusing on different attributes of an audit, such as outcomes, processes and judgments.

27. In 2014, the International Auditing and Assurance Standards Board developed *A Framework for Audit Quality: Key Elements That Create an Environment for Audit Quality*. The framework acknowledged the complexities involved in defining audit quality

[23] TD/B/C.II/ISAR/56.

[24] The Accounting Development Tool addresses legal and regulatory foundations for audits in pillar A in the following: A2 – audit standards; A4 – enforcement, monitoring of implementation and compliance; A5 – licensing of auditors; A7 – ethics; and A8 – investigation, discipline and appeals.

and stated that the International Standards on Auditing issued by the Board provided an important foundation that supported audit quality. It identified a number of key elements, namely input, process, output factors, key interactions in financial reporting supply chains and contextual factors that contributed to audit quality at engagement, audit firm and national levels. The Board considers a quality audit to have been achieved by an engagement team that exhibited appropriate values, ethics and attitudes; was sufficiently knowledgeable, skilled and experienced and had sufficient time allocated to perform the audit work; applied a rigorous audit process and quality control procedures that complied with laws, regulations and applicable standards; provided useful and timely reports; and interacted appropriately with relevant stakeholders.

28. Although there is a general understanding that the clarified ISAs contribute to further improvements in audit quality, a few accounting firms have cautioned against assuming that the International Standards on Auditing will automatically result in harmonization in audit quality, given differences in culture and the stage of development of the auditing profession in different jurisdictions.

29. In a global survey, the International Forum of Independent Audit Regulators concluded that audit firms globally needed to do more to improve the consistency of auditor performance and to operationalize enhanced levels of professional scepticism. It recognized that inspection findings do not, on their own, indicate that changes are necessarily needed to the standards. However, the areas of recurring audit deficiencies, as identified by the survey report, deserve specific attention in the processes of international standard setters.[25] The International Forum is of the view that further investigation in these areas, aimed at evaluating whether and how standards could contribute to preventing a recurrence of such findings in audit firms and audit engagements, would be beneficial to their relevance.

30. In the United States, in June 2015, the Public Company Accounting Oversight Board published for public consultation a proposal on the potential use of a group of indicators intended to improve audit quality (see http://pcaobus.org/Rules/Rulemaking/Docket%20041/Release_2015_005.pdf). The proposal stated that the indicators were a potential portfolio of quantitative measures that might provide new insights on how to evaluate the quality of audits and how high-quality audits might be achieved. Taken together with a qualitative context, they might inform discussions among those concerned with the financial reporting and auditing process, for example audit committees and firms.

31. Another important and complex area is the issue of independence with regard to audit regulators and audit practitioners. The International Forum of Independent Audit Regulators, in its principle No. 2 of the core principles for independent audit regulators, states that an audit regulator's independence "means the ability to undertake regulatory activity and to take and enforce decisions without external interference by those regulated. The audit regulator should be operationally independent from external political interference and from commercial or other sectoral interests in the exercise of its functions and powers, including not being controlled in its governance by audit practitioners. The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities".[26]

32. Similarly, the International Ethics Standards Board for Accountants, in section 290 of its code of ethics for professional accountants, on audit and review engagements, states that independence comprises the following:

[25] International Forum of Independent Audit Regulators, 2015, Report on 2014 survey of inspection findings.

[26] International Forum of Independent Audit Regulators, 2015, Core principles for independent audit regulators, available at http://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf (accessed 20 August 2015).

(a) "Independence of mind: The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism

(b) Independence in appearance: The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional scepticism has been compromised" (see http://www.ethicsboard.org)

33. The Institute of Chartered Accountants in England and Wales states that the most effective way to ensure independence is to provide guidance centred on a framework of principles rather than a detailed set of rules that may be complied with to the letter but circumvented in substance. Such an approach sets out fundamental ethical principles, provides a reasoned analysis of the possible threats to these principles and gives guidance on safeguards that may be necessary to mitigate these threats (see http://www.icaew.com).

34. In the European Union, a Green Paper issued after the financial crisis in 2008 initiated a debate on a number of audit-related issues including, among others, the role of the auditor, the governance and the independence of audit firms, and the supervision of auditors.[27] Directive 2014/56/EU states that to enhance the independence of statutory auditors and audit firms, auditors should not be involved in the audited entity's decision-making process and should keep records of all threats to their independence and of the safeguards applied to mitigate those threats, and that "where the threats to their independence, even after the application of safeguards to mitigate those threats, are too significant, they should resign or abstain from the audit engagement".

35. Implementation of the International Standards on Auditing in a country may be more efficient if the standards are available in the national language in which they will be practically implemented. In this regard, the establishment of due process for translation is critical. Successful and timely translation of auditing standards was emphasized as an important component of the International Auditing and Assurance Standards Board clarity project. Recognizing that translation necessitates access to approved texts of the clarified ISAs, the Board has made them available on the International Federation of Accountants website. Translation remains a major challenge in the adoption and implementation of the International Standards on Auditing and certain issues remain, including on the use of words that allow for different interpretations of the requirements of the standards, which raises concerns regarding the consistent application of the clarified ISAs across countries. A possible solution may be to address this challenge at a regional level, as described in box 1.

Box 1. Good practices in the translation of standards

In 2012, a consortium of professional accountancy organizations in Latin America translated the *Handbook of International Standards on Auditing and Quality Control* into Spanish. The group consisted of the Spanish Institute of Chartered Accountants and Institute of Accounting and Auditing and a review committee led by the Argentinian Federation of Professional Councils in Economic Sciences, with representatives from member bodies of the International Federation of Accountants in the Plurinational State of Bolivia, Chile, Colombia, Costa Rica, Mexico, Panama, Paraguay and Uruguay, and other

[27] European Commission, 2010, Audit policy: Lessons from the crisis, Green Paper. Also see C Humphrey, A Kausar, A Loft and M Woods, 2011, Regulating audit beyond the crisis: A critical discussion of the European Union green paper, *European Accounting Review*, 20(3):431–457.

key stakeholders. This is one example of how countries sharing a language may join efforts to facilitate the consistent implementation of the International Standards on Auditing among them by overcoming translation differences and also gaining from economies of scale.

Source: International Federation of Accountants, 2012, Press release, available at https://www.ifac.org/news-events/2012-04/ifac-welcomes-publication-single-spanish-translation-handbook-international-stan (accessed 20 August 2015).

36. The efficient implementation of the International Standards on Auditing also requires explanatory materials that provide guidance on the practical application of regulatory pronouncements. Many respondents to the consultations of the International Auditing and Assurance Standards Board, including accounting firms, called for additional guidance in specific areas. However, several respondents were of the view that the clarified ISAs had led to an unnecessary increase in the volume of audit documentation, especially for SMEs. While a few respondents held the view that additional documentation clarified an auditor's thought process, others were of the view that the documentation requirements were excessive and led to a compliance mentality.[28]

2. Monitoring of compliance and enforcement

37. As with other international standards, the application of the International Standards on Auditing largely depends on requirements for the monitoring of implementation and enforcement. Developing an adequate monitoring and enforcement system is a challenging task. As noted at the thirty-first session of the Intergovernmental Working Group of Experts, a sound national system of monitoring of compliance and enforcement requires a clear understanding of the concept of such monitoring, its objective and its scope, taking into account its interrelations with other aspects of the legal and institutional systems of a country.[29] Such a system also includes designing a set of activities for the monitoring of compliance and enforcement and methodologies for both the prevention and correction phases, as well as the allocation of appropriate human, financial and technological resources and an adequate organizational structure that promotes a fair, transparent and efficient process, including coordination mechanisms with other areas of legislation and regulation and other authoritative bodies at national and international levels, as well as at regional levels if regional enforcement mechanisms exist (for example in the European Union). Effective oversight of those performing audit services is critical for the reliability and integrity of the financial reporting process.[30]

38. In some developing countries, insufficient legal infrastructure has impacted the efficiency of the implementation of the International Standards on Auditing. In some areas where these standards have been adopted, existing national legislation (for example companies law) has not been revised to make the application of the standards mandatory for audits of financial and non-financial reports. Consequently, auditors do not have any legal obligation to adhere to the requirements of the International Standards on Auditing. In some countries, the legislative process for approving standards is lengthy. In addition, the sharing of responsibilities between a number of government agencies (for example registrars of joint stock companies, securities and exchange commissions, professional accountancy bodies and judiciaries) complicates the enforceability of auditing standards.

[28] International Auditing and Assurance Standards Board, 2013.

[29] TD/B/C.II/ISAR/70.

[30] For more details on issues related to monitoring, compliance and the enforcement of audit requirements, see TD/B/C.II/ISAR/70.

39. Many international organizations address this issue from different perspectives. At a global level, the International Forum of Independent Audit Regulators has developed a set of core principles that seek to promote effective independent audit oversight globally; assist its members in developing their own national arrangements through being able to draw on and benefit from the experience of other Forum members; advance widespread audit oversight practices aimed at fostering high-quality audits and promoting public trust in the financial reporting process; and support cooperation between regulators and promote greater consistency in audit oversight. In particular, these principles require that the responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation, and that audit regulators should be independent, transparent and accountable and have comprehensive enforcement powers (the capability to ensure that their inspection findings or recommendations are appropriately addressed and the ability to impose a range of sanctions, including for example fines and the removal of an audit licence and/or registration), and also ensure that their staff members are independent from the profession. Furthermore, staff members of oversight bodies need to have appropriate competencies and be sufficient in number. They need to be objective and free from conflicts of interest and should maintain appropriate confidentiality arrangements. Audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties. The set also includes principles for inspection, including a risk-based inspection programme and mechanisms for reporting inspection findings to an audit firm.

40. The World Bank, as part of its Report on the Observance of Standards and Codes programme, has stressed the need for the establishment of independent oversight bodies of the audit profession and suggested significant enhancements in the capacity and powers of various regulatory bodies.[31] In addition, the World Bank has acknowledged the importance of programmes on setting auditing and ethical standards, audit quality assurance and the improvement of coordination among related bodies, all within a coherent and consistent legislative framework (see box 2).

Box 2. Recent developments in national oversight mechanisms

Recent World Bank reports on the observance of standards and codes for Bangladesh (2015), Indonesia (2010), Mauritius (2011) and Nigeria (2011) suggest that these States have either set up a financial reporting council or are in the process of making regulatory amendments to allow for the establishment of such an oversight body. Recent recommendations in the reports on the observance of standards and codes for Afghanistan (2010), Bhutan (2009), Bosnia and Herzegovina (2010), Burundi (2014), Chad (2014), Kenya (2010) and the Republic of Moldova (2013) have called for setting up dedicated government-controlled oversight bodies for the monitoring and implementation of the International Standards on Auditing. However, the establishment of such bodies can only achieve desired results if other related bodies also improve their performances.

Sources: World Bank, 2015, Reports on the observance of standards and codes – Topics: Accounting and auditing, available at http://www.worldbank.org/ifa/rosc_aa.html (accessed 20 August 2015) and W Chapal, 2015, Upholding reputation of financial reporting, *The Financial Express*, 25 July.

[31] This has been a major component of the Report on the Observance of Standards and Codes programme (see World Bank, 2015, and J Hegarty, F Gielen and AC Hirata Barros, 2004, Implementation of international accounting and auditing standards: lessons learned from the World Bank's Accounting and Auditing reports on the observance of standards and codes programme, available at http://www.worldbank.org/ifa/LessonsLearned_ROSC_AA.pdf (accessed 20 August 2015).

available at http://www.thefinancialexpress-bd.com/2015/07/25/101406/print (accessed 20 August 2015).

41. In situations where it is not possible to establish an independent oversight body, the World Bank reports referred to in box 2 recommended that Governments and central banks play an enhanced role in ensuring the proper monitoring and enforcement of the International Standards on Auditing. For example, Governments could play a more proactive role in ensuring better governance of State-owned enterprises, including the appointment of auditors. Central banks could play a more dynamic role to ensure that the financial statements of banks under their supervision are more meaningful.[32]

42. Compliance mechanisms should also consider that audit firms usually have methodologies that provide further specifications on existing audit regulations. Furthermore, even within the structure created by auditing standards and audit methodologies developed by audit firms, there is flexibility for the engagement team in terms of the specific audit work to be performed, how it is to be undertaken in practice and the nature and timing of interactions with management.

B. Institutional settings

43. A strong institutional foundation is another critical factor in the efficient application of the International Standards on Auditing. As suggested in the Accounting Development Tool capacity-building framework, the following elements should be considered in addressing this issue:[33]

- Statutory responsibilities and legal status of each body in the regulatory framework, clarifying any regulatory roles delegated by the State to specific agencies and/or the accountancy profession
- Governance arrangements in each regulatory body, including how members are appointed and their duties, as well as the issue of independence
- Interaction, coordination and cooperation among different institutions
- Management structures of each body
- Funding arrangements, staff competency and sustainability in each body
- Strong and well-governed professional accountancy organization

44. A number of recent studies and reports have highlighted the following three key challenges in institutional capacity-building: lack of clarity regarding the roles and responsibilities of the main players in this area, such as Governments, professional accountancy organizations, oversight bodies and other stakeholders;[34] lack of legal and

[32] However, some national professional accountancy bodies have expressed concerns that the formation of an oversight body such as a financial reporting council could lead to additional bureaucratic burdens and, subsequently, increase the cost of conducting audits.

[33] The Accounting Development Tool addresses institutional foundations for audits in pillar B in the following: B2 – audit standard setting body and a standard-setting due process; B4 – institutional setting in compliance, monitoring and enforcement; B5 – institutional arrangements for auditor licensing; B6 – coordination mechanism; B7 – institutional aspects of implementation of ethics requirements for auditors; and B8 – institutional aspects with regard to the professional accountancy body.

[34] Memorandum of Understanding to Strengthen Accountancy and Improve Collaboration, 2013 *Professional Accountancy Organizations Global Development Report* (New York, International

regulatory support for professional accountancy organizations for performing core functions integral to the development of competent and capable accountancy professionals and the production of high-quality financial and non-financial information;[35] and resource constraints, which remain a critical challenge for developing countries in their efforts to implement the International Standards on Auditing. Remuneration offered by government regulatory bodies is generally not sufficient to attract qualified personnel and, consequently there is insufficient capacity and technical expertise to monitor compliance with International Standards on Auditing. In addition in some countries, professional accountancy organizations tend to rely on volunteers to implement their programmes, which can result in skills mismatches, delays and organizational inefficiencies, and greatly limit the impact of the efforts of the professional accountancy organizations. In this regard, donor support can play an important role. In some countries (for example Liberia, Lesotho and Rwanda), support from the donor community has greatly aided in raising awareness of the importance of a strong accountancy profession.[36] A key development in this area is the recent Memorandum of Understanding to Strengthen Accountancy and Improve Collaboration, which is expected to play a critical role in enhancing the institutional capacities of professional accountancy organizations, as detailed in box 3.

Box 3. Memorandum of understanding to strengthen accountancy and improve collaboration

This memorandum, signed in 2011, sets the basis for improving cooperation and collaboration between the International Federation of Accountants, international donors and the international development community, to strengthen the accountancy profession globally by enabling international donors and professional accountancy organizations to better support the development of the capacity of the accountancy profession in emerging and developing economies, thereby contributing to economic growth and reducing poverty. The memorandum's signatories are as follows: African Development Bank; Asian Development Bank; Australian Agency for International Development (now the aid programme under the Department of Foreign Affairs and Trade); development cooperation of the Finnish Ministry for Foreign Affairs; Gavi – the Vaccine Alliance; Global Fund to Fight AIDS, Tuberculosis and Malaria; Inter-American Development Bank; International Federation of Accountants; New Zealand Aid Programme; Swedish International Development Cooperation Agency; United Kingdom Department for International Development; United States Agency for International Development; and World Bank.

Source: International Federation of Accountants, 2015, About the memorandum of understanding to strengthen accountancy and improve collaboration, available at https://www.ifac.org/mosaic/about-mosaic (accessed 20 August 2015).

45. An efficient system for the monitoring of compliance and enforcement should have a stable source of funding, which will enhance its independence. Funding and independence are closely interconnected. For example, the International Forum of Independent Audit Regulators, in its core principles for independent audit regulators, emphasizes the need for an audit regulator to have a stable source of funding that is secure and free from influence by auditors and audit firms, and sufficient to execute its powers and responsibilities.

Federation of Accountants, with the African Development Bank, Asian Development Bank, Inter-American Development Bank and World Bank).

[35] Ibid.

[36] Ibid.

46. Consistent implementation and enforcement of the International Standards on Auditing requires institutional coordination at all levels. Cooperation and coordination are critical to ensuring consistent and coherent regulatory requirements, the sharing of information on the registration of auditors and audit firms, and collaboration between domestic authorities and foreign counterparts, taking into consideration confidentiality issues, as detailed in box 4.

Box 4. Good practices in cooperation

In 2011, the Accounting and Corporate Regulatory Authority of Singapore formed an informal cooperation group, the Association of Southeast Asian Nations Audit Regulators Group, with the independent audit regulators of Malaysia and Thailand. The group holds periodic meetings with the four largest regional firms to discuss audit quality matters.

In the European Union, the European Securities and Markets Authority established the European Enforcers Coordination Sessions, a forum of 37 enforcers from European Union member States and two countries in the European Economic Area. The forum constitutes the largest network of enforcers with supervision responsibilities in international financial reporting standards globally. Through the forum, European enforcers share and compare their practical experiences. In 2005, the European Securities and Markets Authority established an internal database as a platform for sharing information on a continuous basis.

Sources: Accounting and Corporate Regulatory Authority, 2013, Practice monitoring programme – seventh public report, available at http://www.acra.gov.sg/Publications/Reports/Practice_Monitoring_Programme_Public_Reports/ (accessed 20 August 2015), and European Securities and Markets Authority, 2014, *Report: Activities of International Financial Reporting Standards Enforcers in Europe in 2013* (Paris).

47. The post-implementation review of the International Auditing and Assurance Standards Board also emphasized the need for increased liaison between accounting firms and regulators to ensure a consistent application of regulatory pronouncements.

C. Human capacity requirements

48. Availability of adequate human resources for the efficient implementation of the International Standards on Auditing is of fundamental importance. However, the number of charted accountants in some developing countries remains low.[37]

49. The Accounting Development Tool addresses human capacity foundations for audits and assurances in pillar C and suggests that the following elements should be considered in addressing this issue:

- Professional education and training (including entry requirements and the content of an education programme)
- Professional skills and general education (including professional values, ethics and attitudes)

[37] For a review of challenges faced by developing countries in the implementation of international accounting, auditing and corporate governance standards, see J Siddiqui and CS Ferdous, 2014, The regulatory conundrum: Achieving corporate governance reforms in developing countries, in *Corporate Social Responsibility, Sustainability, Ethics and Governance*, S Boubaker and DK Nguyen, eds., Springer, Berlin-Heidelberg: 445–464.

- Assessment of accounting capabilities and competencies
- Practical experience requirements
- Continuing professional development
- Advanced-level and specialized training in auditing after initial professional development

50. Professional accountancy organizations play a central role in human capacity development. Recent country case studies conducted by UNCTAD clearly demonstrated the importance of strong professional accountancy organizations in the development of qualified professionals to implement international standards of accounting and auditing.[38] In the pre-qualification stage, such organizations provide candidates with the necessary support to successfully complete the qualification process, including arranging for proper practical experience. Such organizations also play a key role in supporting the continuing professional development of their members in the post-qualification stage. They hold their members responsible for adhering to applicable codes of ethics, and they conduct investigations and discipline their members when deviations occur.

51. A certification system that includes appropriate entry criteria, professional accountancy education, assessments, practical experience and continuing professional development, in line with the international education standards of the International Accounting Education Standards Board, results in better educated and skilled professionals capable of meeting the demands of the modern dynamic marketplace.

52. Some good practices in building human capacity for the implementation of the International Standards on Auditing include the following: specialized online learning programmes aimed at developing better understanding of the clarified ISAs;[39] twinning arrangements to obtain best practices, insight and guidance on the development of their systems from more established professional accountancy organizations; and mutual recognition arrangements (see for example http://www.asean.org/communities/asean-economic-community/item/asean-mutual-recognition-arrangement-framework-on-accountancy-services-3), as described in box 5.

Box 5. Mutual recognition arrangements

UNCTAD country case studies show that some countries are working towards setting accounting qualifications that are mutually recognized through a regional framework agreement, especially with neighbouring countries. For example, in East Africa, in 2010, the United Republic of Tanzania removed limitations on the provision of accounting services across borders in all modes of supply with Kenya and Rwanda. In addition, Malaysia has two mutual recognition arrangements, with Australia and Indonesia.

Source: UNCTAD, 2014.

53. The development of second-tier, technician-level certifications could also facilitate the process. In recent years, several professional accountancy organizations have incorporated such certification and membership categories into their organizations, to

[38] UNCTAD, 2014, *International Accounting and Reporting Issues: 2013 Review* (New York and Geneva, United Nations publication).

[39] For example, the Institute of Chartered Accountants in England and Wales offers an online learning and assessment programme on clarified ISAs (see http://www.icaew.com/en/qualifications-and-programmes/icaew-isas-programme/about-icaew-isas-programme).

further develop and address the needs of the broader profession and provide an education and certification system that better fits the needs of the economy.[40]

54. Recruiting the right calibre of staff to the auditing profession is essential to audit quality. In many countries, university graduates, particularly those specialized in accounting and business, are an important source of recruits. However, the poor quality of accounting education at the undergraduate level has been a cause of concern in the development of professional accountancy education in developing countries as, in many developing countries, accounting degrees offered in universities lack proper exposure to accounting practices.[41] For example, in Latin America the main prerequisite for membership in a professional accountancy organization and/or recognition as a professional accountant or auditor is a degree in accounting issued by a public or private university.[42]

55. Recently, university curricula in some countries have been updated to include International Standards on Auditing and international financial reporting standards, although these may not have been harmonized across universities within a country.[43] The quality of teaching and examinations remains a significant challenge. As most instruction materials and international training events and seminars are made available mostly in English, the level of English communications skills also remains an area of concern.[44] There is a need to focus more attention on enhancing the training of university professors in international standards, including International Standards on Auditing and international financial reporting standards.

IV. Conclusion

56. In recent years, there has been significant growth in the adoption of the International Standards on Auditing. Many jurisdictions have either adopted the clarified ISAs or have committed to adopt the standards in the foreseeable future. The outcomes of the clarity project of the International Auditing and Assurance Standards Board appear to have been well received by many stakeholders. The clarified ISAs have enhanced the understandability of the standards and are considered to be a significant improvement on the preceding standards. However, the post-implementation review by the Board emphasized the need for further efforts towards the development and efficient implementation of the International Standards on Auditing.

57. In addition, given differences in culture and the stage of development of the auditing profession in different jurisdictions, the need for capacity-building towards efficient implementation of the International Standards on Auditing by various national regulatory and professional bodies, as well as accounting firms – especially smaller firms – has been acknowledged.

58. This background note has reviewed the main issues in the implementation of the International Standards on Auditing, such as legal, institutional and human resources development challenges. Delegates at the thirty-second session of the Intergovernmental Working Group of Experts may wish to consider the issues outlined, as well as the following questions:

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[40] Memorandum of Understanding to Strengthen Accountancy and Improve Collaboration, 2013.

[41] World Bank, 2010, Report on the observance of standards and codes: Kenya and World Bank, 2011, Report on the observance of standards and codes: Nigeria.

[42] Memorandum of Understanding to Strengthen Accountancy and Improve Collaboration, 2013.

[43] World Bank, 2011.

[44] For recent information on Bangladesh, see World Bank, 2015, Report on the observance of standards and codes: Bangladesh, and J Siddiqui and C Humphrey, 2015, Audit profession in an emerging economy: exploring the art of survival, University of Manchester.

(a) What role do the International Standards on Auditing play in achieving high-quality and internationally comparable corporate reports?

(b) What are the major areas that need to be considered in building capacity for efficient and consistent implementation of the International Standards on Auditing? What are good practices and lessons learned?

(c) How might member States enhance coordination in capacity-building in the area of audits along the reporting chain (including regulatory and enforcement bodies, professional organizations and audit firms) and at the international level?

(d) What are some of the specific audit-related challenges in areas such as the public sector, SMEs and non-financial reporting?

(e) How can global forums such as the Intergovernmental Working Group of Experts further contribute to better promotion and implementation of the International Standards on Auditing?